

REPORT OF EXAMINATION
OF THE
LANDMARK INSURANCE COMPANY
AS OF
DECEMBER 31, 2008

Participating State
and Zone:

California

Filed June 28, 2010

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Los Angeles, California
May 13, 2010

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable Christina Urias
Secretary, Zone IV-Western
Director of Insurance
Arizona Department of Insurance
Phoenix, Arizona

Honorable Steve Poizner
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman, Secretary, and Commissioner:

Pursuant to your instructions, an examination was made of the

LANDMARK INSURANCE COMPANY

(hereinafter also referred to as the Company) at the primary location of its books and records, 175 Water Street, New York, New York 10038. The Company's statutory home office is located at 2730 Gateway Oaks Drive, Suite 100, Sacramento, California 95833, and its main administrative office is located at 100 Summer Street, Boston, Massachusetts 02110.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2005. This examination covers the period from January 1, 2006 through December 31, 2008. The examination was made pursuant to the National Association of Insurance Commissioners' plan of examination. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and

an evaluation of the assets and a determination of liabilities as of December 31, 2008, as deemed necessary under the circumstances.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: Corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of the Company; business in force by states; loss experience; accounts and records; and sales and advertising.

The examination of the Company was performed concurrently with the examination of the following Delaware domiciled affiliated companies:

Lexington Insurance Company

AIG Excess Liability Insurance Company Ltd.

SUBSEQUENT EVENTS

In May 2009, Edward Liddy, Chairman and Chief Executive Officer (CEO) of American International Group, Inc. (AIG), the Company's ultimate parent, resigned pending the appointment of a replacement. In August 2009, AIG's Board of Directors elected Robert Benmosche as AIG's President and CEO.

In July 2009, AIG rebranded its general insurance operations as "Chartis". Chartis consists of commercial insurance (operating as Chartis U.S.), foreign general insurance (operating as Chartis International), and private client group (part of Chartis U.S.). Through this rebranding, the names of the following companies were changed:

<u>Original Company Name</u>	<u>New Company Name</u>	<u>Jurisdiction</u>
AIU Holdings, Inc.	Chartis Inc.	Delaware
AIU Holdings, LLC	Chartis International, LLC	Delaware
AIG Casualty Company	Chartis Property Casualty Company	Pennsylvania
AIG Excess Liability Insurance Company Ltd.	Chartis Select Insurance Company (Chartis Select)	Delaware
AIG Excess Liability Insurance International Limited	Chartis Excess Limited	Ireland
American International Specialty Lines Insurance Company	Chartis Specialty Insurance Company (Chartis Specialty)	Illinois

On April 21, 2009, AIG announced its intent to contribute Chartis Inc., the Company's intermediate parent company (formerly AIU Holdings, Inc.), and Chartis International, LLC (formerly AIU Holdings, LLC) to a newly formed special purpose vehicle (SPV) in exchange for membership interests in the SPV, subject to receipt of applicable regulatory approvals. On July 27, 2009, AIG announced the formation of the SPV, and on January 29, 2010, AIG contributed Chartis Inc. to the SPV. AIG contributed Chartis International, LLC to the SPV on March 12, 2010.

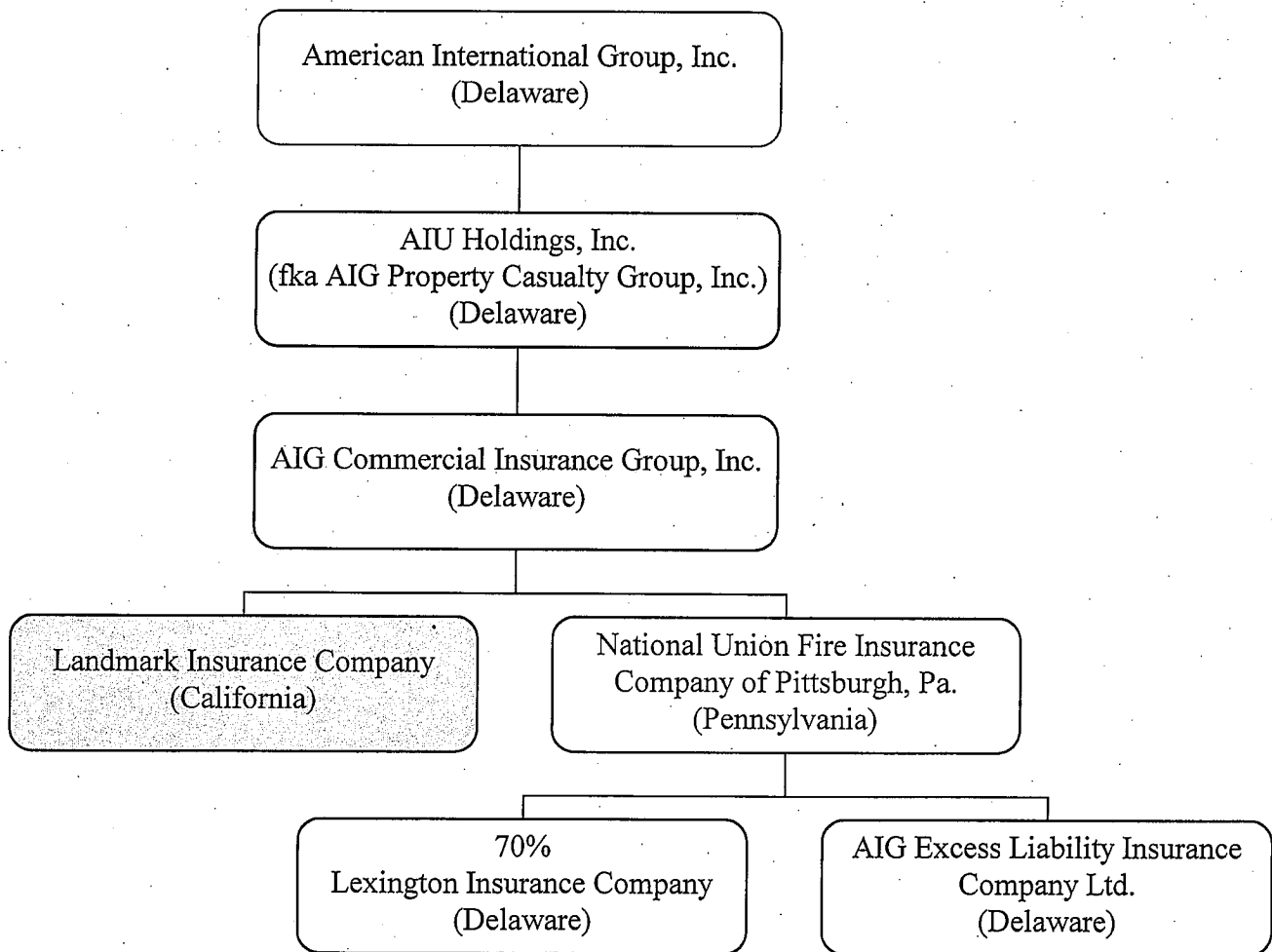
COMPANY HISTORY

The Company was incorporated in California on February 10, 1977 and has been a member of the American International Group, Inc. (AIG) holding system since its incorporation. Effective December 29, 2006, direct ownership of the Company was transferred to AIG Commercial Insurance Group, Inc, which was subsequently renamed Chartis U.S., Inc. on July 27, 2009.

On December 31, 2008, the Company received a capital contribution of \$333,158 from AIG Commercial Insurance Group, Inc.

MANAGEMENT AND CONTROL

The Company is a direct wholly-owned subsidiary of AIG Commercial Insurance Group, Inc., which is a direct wholly-owned subsidiary of AIU Holdings, Inc. AIU Holdings, Inc. is a wholly-owned subsidiary of American International Group, Inc. (AIG) and serves as the holding company for AIG's domestic general insurance and non-insurance companies. The control of the Company is maintained by the AIG's ownership of all voting securities of AIU Holdings, Inc. The following abridged organizational chart, which is limited to the Company's ultimate parent along with certain of its other affiliated insurance companies, depicts the Company's relationship within the holding company system as of December 31, 2008:



(*) All ownership is 100% unless otherwise noted.

Management of the Company is vested in a nine-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2008 follows:

Directors

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Merton Bernard Aidinoff ⁽¹⁾ New York, New York	Retired Partner Sullivan & Cromwell
Charles Harry Dangelo ⁽²⁾ Manasquan, New Jersey	Vice President American International Group, Inc.
John Quinlan Doyle Rye, New York	President and Chief Executive Officer AIG Commercial Insurance Group, Inc.
Neil David Fields New York, New York	President AIG Risk Finance
David Lawrence Herzog St. Albans, Missouri	Senior Vice President and Comptroller American International Group, Inc.
Kristian Philip Moor Fairfield, Connecticut	Executive Vice President American International Group, Inc.
Win Jay Neuger ⁽³⁾ New York, New York	Executive Vice President and Chief Investment Officer American International Group, Inc.
Robert Scott Higgins Schimek Newtown, Pennsylvania	Senior Vice President and Chief Financial Officer/Treasurer Certain subsidiaries of American International Group, Inc., including the Company
Mark Timothy Willis Naperville, Illinois	Executive Vice President AIG Commercial Insurance Group, Inc.

⁽¹⁾ Not re-elected on May 19, 2009.

⁽²⁾ Resigned effective February 26, 2009.

⁽³⁾ Resigned effective February 20, 2009.

Principal Officers

<u>Name</u>	<u>Title</u>
John Quinlan Doyle	Chairman
Peter James Eastwood	President, Chief Executive Officer
Amy Marie Cinquegrana ⁽⁴⁾	Secretary
Robert Scott Higgins Schimek	Senior Vice President, Chief Financial Officer/Treasurer
Nicholas Edward Anselmo	Executive Vice President
David Joseph Bresnahan	Executive Vice President
Richard Henry Bucilla ⁽⁵⁾	Executive Vice President
George Robert Stratts ⁽⁶⁾	Executive Vice President
Andrew Paul Archambault ⁽⁷⁾	Senior Vice President
John Mathew Artesani	Senior Vice President
Irene Elizabeth Carmody	Senior Vice President
Charles Harry Dangelo ⁽⁸⁾	Senior Vice President
Frank Hienmen Douglas, Jr.	Senior Vice President
Frederik Matak Fontein	Senior Vice President
Louis Peter Frascotti	Senior Vice President
Andrew Robert Holland	Senior Vice President
David Andrew Jordan ⁽⁹⁾	Senior Vice President
Anthony Mammolite ⁽¹⁰⁾	Senior Vice President
Edward George Mazman ⁽¹¹⁾	Senior Vice President
Mary Elizabeth McCoy	Senior Vice President
Gary Eugene Muoio	Senior Vice President
Stephen Joel Paris	Senior Vice President
Alan Richard Person	Senior Vice President
Richard Thomas Pisano	Senior Vice President
Matthew Francis Power	Senior Vice President
Vincent Nikolas Pugliese	Senior Vice President
Douglas Gordon Story	Senior Vice President
Ervino John Valle	Senior Vice President
Nicholas Charles Walsh	Senior Vice President
Richard Carl Woollams, Jr.	Senior Vice President
Brenda Gail Osborne	Senior Vice President

⁽⁴⁾ Resigned effective February 20, 2009.

⁽⁵⁾ Deceased 2010.

⁽⁶⁾ Resigned effective October 6, 2009.

(7) Resigned effective March 23, 2009.

(8) Resigned effective February 26, 2009.

(9) Resigned effective June 4, 2009.

⁽¹⁰⁾ Resigned effective June 4, 2009.

⁽¹¹⁾ Resigned effective January 23, 2009.

Intercompany Agreements

Services and Expense Agreement: American International Group, Inc. (AIG) and certain of its subsidiaries, including the Company, are parties to the Service and Expense Agreement. Pursuant to this agreement, the Company reimburses the other affiliated parties at actual cost for various services including, but not limited to, advertising, accounting, actuarial, tax, legal, data processing, claims and adjustment, employee cafeteria, office space, and payroll. For 2006, 2007, and 2008, the Company reimbursed \$935,735, \$886,881, and \$936,296, respectively, in service fees to the other affiliated parties. This agreement has been in force since 1974.

Joint Asset Agreement: This agreement, effective October 1, 1986, was entered into by the Company, AIG Capital Corporation (Capital Corp.), American International Group, Inc. (AIG), and certain of AIG's subsidiaries for the purpose of owning, maintaining, investing, and reinvesting certain of their monies. The parties to this agreement appointed Capital Corp. as the manager and investment advisor for these jointly owned assets. During the years under examination, no transactions occurred under this agreement. This agreement was terminated effective January 27, 2010.

Investment Management Contract: This agreement, effective January 1, 1991, was entered into by the Company and AIG Global Investment Group, Inc (AIGGIG). Pursuant to this agreement, AIGGIG provides investment management and advisory services to the Company for an annual fee of seventy-five cents (\$0.75) per thousand dollars of assets under management. For 2006, 2007, and 2008, the Company paid \$156,584, \$159,417, and \$151,158, respectively, in service fees to AIGGIG.

Surplus Lines Program Administrator Agreement with Gulf Agency: The Company and Lexington Insurance Company entered into a Surplus Line Program Administrator Agreement, effective January 1, 2006, with affiliates, Gulf Agency, Inc. and Agency Management Corporation (program

administrators). Pursuant to this agreement, the program administrators provide administrative services including, but not limited to, underwriting, issuance of insurance policies and endorsements, collection and handling of premiums and other funds, and cancellation of policies. In return for the services, the Company compensates the program administrators with a commission, which covers the program administrators' direct expenses plus 1% of the expenses as administration fee. On May 21, 2010, the Company sent the program administrators a written notice of its intent to terminate this agreement, effective July 21, 2010, pursuant to the termination section of this agreement.

Surplus Lines Program Administrator Agreement with risk specialists companies: Effective January 1, 2006, the Company entered into a Surplus Line Program Administrator Agreement with a number of affiliated risk specialists companies (program administrators). Under this agreement, the program administrators provide various administrative services at actual cost, which include, but are not limited to, underwriting, issuance of insurance policies and endorsements, collection and handling of premiums and other funds, and cancellation of policies. On March 24, 2008, the Company filed this agreement with the California Department of Insurance (CDI). This agreement is currently pending approval from the CDI.

Tax Allocation Agreement: On November 12, 2008, the Company entered into an amended tax allocation agreement (amended agreement) with AIU Holdings, Inc. On April 28, 2009, Landmark executed a revised version of the amended agreement that included statements that clarified the intent of the parties. The amended agreement was effective for the tax year commencing January 1, 2008. The amended agreement amends an existing tax allocation agreement between AIG, the Company's ultimate parent, and the Company dated January 1, 1977, in which the tax liability of the Company was allocated at the level of AIG. Under the amended agreement, the tax liability of the Company is allocated at the level of AIU Holdings, Inc.

AIU Holdings, Inc. also holds tax reserves defined as (1) a liability recorded in accordance with Financial Accounting Standard Board Interpretation No. 48 – Accounting for Uncertainty in Income Taxes or the comparable statutory provision as prescribed by the National Association of Insurance Commissioners, and (2) any tax liability recorded as the result of final audit adjustments by the tax

authorities. The tax reserves are settled at least annually. Furthermore, as of the effective date of this amended agreement, AIU Holdings, Inc. assumed the Company's existing tax reserves. Subsequent changes in tax reserves will be deemed as capital contribution or dividends, as the case may be. Finally, given that a number of the business units slated to be sold by AIG as part of its restructuring efforts are owned by AIG Commercial Insurance companies, the amended agreement clarifies that any realized gains on any such sales will be excluded from the calculation of the Company's tax liability. The amended agreement was replaced by a new subgroup tax sharing agreement (new agreement) for the tax year commencing January 1, 2010. The Company submitted the new agreement to the CDI on March 28, 2010. The new agreement is still pending approval from the CDI.

Capital Maintenance Agreement: Effective February 26, 2009, the Company entered into a Capital Maintenance Agreement with its ultimate parent, AIG. According to the terms of this agreement, in the event that the Company's total adjusted capital falls below 200% of the Company's authorized control level as of December 31, 2008, AIG will provide capital contribution to make the Company's total adjusted capital equal to 200% of the authorized control level. AIG's capital contribution would be cash or cash equivalents. This agreement replaced and superseded similar agreements entered into in 2007 and 2008. Additionally, on February 23, 2010, the Company entered into a similar Capital Maintenance Agreement with AIG that replaced and superseded the February 2009 agreement.

TERRITORY AND PLAN OF OPERATION

The Company writes multiple lines of property and casualty insurance on an admitted basis in the following ten states: Arizona, California, Colorado, Hawaii, Kansas, Massachusetts, Nevada, New York, Oregon, and Washington. The Company derived 36.6% of its direct written premiums as an admitted insurer in the ten states. In addition, the Company operates on a surplus lines basis in several other states.

The Company's direct written premiums increased from \$20.7 million in 2005 to \$27.2 million in 2008. The major lines of business written in 2008 were other liability – occurrence (20.4% of direct premiums), other liability – claim-made (20.2%), and fire (18.7%). Four states accounted for more than 80% of direct premiums written in 2008: New York (41.4%), Delaware (30.2%), Pennsylvania (6.5%), and Texas (5.9%). The Company did not have any direct premiums written in California.

The Company accepts business mainly from licensed insurance brokers. Such brokers usually have no authority to bind the Company to an insurance contract. The Company outsources policy issuance and administration, underwriting, and/or claims adjustment functions to certain program administrators and third-party administrators.

REINSURANCE

Intercompany Pooling Agreement

Effective December 31, 1998, the Company entered into an intercompany pooling agreement with its affiliates, Lexington Insurance Company (Lexington) and AIG Excess Liability Insurance Company Ltd. (AIG Excess) to form a Surplus Lines Pool (Lexington Pool). Pursuant to the terms of this agreement, the pool participants cede all direct and assumed business to Lexington, the lead pool participant. In turn, Lexington retrocedes 2% of the pooled business to the Company and 18% to AIG Excess and retains the remaining 80%. The California Department of Insurance (CDI) approved this agreement on December 30, 1998.

During 2009, an Amended Pooling Agreement between Lexington, Chartis Select, Chartis Specialty, and the Company was submitted to Delaware, Illinois, and the CDI for approval. Under the agreement, Chartis Specialty was added to the existing Lexington Pool and would cede 100% of its existing policyholder assets and liabilities to Lexington. In turn, Chartis Specialty will assume a 10% share of the Surplus Lines Pool. Lexington's participation will be reduced from 80% to 70%. The Company's and Chartis Select's participation percentages remain the same. The Amended Pooling Agreement changes the Lexington Pool participants' percentages as follows:

70% - Lexington
 18% - Chartis Select
 10% - Chartis Specialty
 2% - The Company

The Amended Agreement, with an effective date of January 1, 2010, was approved by the California, Delaware, and Illinois Departments of Insurance.

Reinsurance in General

The Company assumes all authorized lines of business from affiliates on a treaty and facultative basis. The largest net aggregate amount insured under any one risk (excluding workers' compensation) is limited to \$17,840,000. Effective May 1, 2009, the Company placed reinsurance reducing the largest net exposure under any one risk limit to \$10,000,000. For 2008, the Company reported the following distribution of net premiums written:

Direct Business	\$27,183,920
Reinsurance Assumed From Affiliates	<u>142,911,799</u>
Total Direct and Assumed	<u>170,095,719</u>
Reinsurance Ceded to Affiliates	40,474,005
Reinsurance Ceded to Non-Affiliates	<u>29,639,943</u>
Total Ceded	<u>70,113,948</u>
Net Premiums Written	<u><u>\$99,981,771</u></u>
Percentage Ceded of Gross	41.2%

Assumed

Most of the Company's assumed business is through the Surplus Lines Pool (Lexington Pool). The Company also assumes business from affiliates on a treaty and facultative basis. The Company assumes business only in states where it is licensed.

The Company is a member of an AIG internal facility known as the Compulsory Cessions Account (CCAA) facility. For certain new and renewal business, various member companies of AIG cede business to the CCAA facility. Some of the business ceded to the CCAA facility is between different divisions of companies within the same Inter-company Pool. For example, any business written on the paper of members of the Lexington Pool stays within that pool without cession to American Home Assurance Company (American Home). American Home or Lexington Insurance Company (Lexington), on behalf of their respective pools, retains 100% of the CCAA's participation.

Prior to the CCAA facility, a previous Compulsory Cessions Account (CCA) facility worked in the same manner as the CCAA facility. With the CCA facility, Lexington, on behalf of the Surplus Line Pool, would retain 92% of the CCA participation and retrocede the remaining 8% to Transatlantic Reinsurance Company. As of December 31, 2004, the CCA facility was placed in run-off.

Ceded

The following reinsurance programs are presented on a 100% pooling basis of which the Company's share is 2%.

The Company has property reinsurance which is placed through domestic and foreign reinsurers. The program consists of working and excess layers that cover all property business. In addition, Lexington is a named participant (with certain other AIG insurance subsidiaries and affiliates) under AIG's "external" property catastrophe program. This excess protection covers all AIG property exposures. The summary of this program is highlighted below.

A supplemental coverage for the accident year 2002 was available with loss ratios greater than 88% with National Union Fire Insurance Company of Pittsburgh, Pa., (National Union), an affiliate. Further segmentation of the property reinsurance program is provided for specific homeowners lines of business.

Property – Major Working Reinsurance Layers:

Commercial Property Quota share coverage, limit of \$10 million, 1.80% placed

Property per risk excess of loss coverage, \$15 million in excess of \$10 million, 64.21% placed

Property per risk excess of loss coverage, \$75 million in excess of \$25 million, 70.00% placed

Property per risk excess of loss coverage, \$150 million in excess of \$100 million, 90.50% placed

Property per risk excess of loss coverage, \$250 million in excess of \$250 million, 95.00% placed

Property per risk excess of loss coverage, \$500 million in excess of \$500 million, 95.00% placed

Property per risk excess of loss coverage, \$500 million in excess of \$1 billion, 95.00% placed

7% Personal Lines Homeowners Property quota share limit \$5 million.

40% Personal Lines Umbrella quota share limit \$5 million.

Property – Catastrophe Reinsurance:

1st layer property catastrophe coverage, 60% of \$250 million in excess of \$1 billion

2nd layer property catastrophe coverage, 60% of \$250 million in excess of \$1.25 billion

3rd layer property catastrophe coverage, 60% of \$100 million in excess of \$1.5 billion

4th layer property catastrophe coverage, 50% of \$200 million in excess of \$1.6 billion

5th layer property catastrophe coverage, 50% of \$200 million in excess of \$1.8 billion

6th layer property catastrophe coverage, 60% of \$250 million in excess of \$2 billion

7th layer property catastrophe coverage, 60% of \$250 million in excess of \$2.25 billion

8th layer property catastrophe coverage, 60% of \$250 million in excess of \$2.5 billion

9th layer property catastrophe coverage, 60% of \$250 million in excess of \$2.75 billion

10th layer property catastrophe coverage, 60% of \$250 million in excess of \$3 billion

11th layer property catastrophe coverage, 60% of \$250 million in excess of \$3.25 billion

12th layer property catastrophe coverage, 60% of \$250 million in excess of \$3.5 billion

13th layer property catastrophe coverage, 100% of \$750 million in excess of \$3.75 billion

Casualty: Primary Casualty Non-Professional (claims-made basis and claims-incurred basis) – 0.5% quota share, maximum net \$995,000, maximum ceded \$5,000. Employment Practices Liability (claims-made basis and claims-incurred basis) - 10% quota share, maximum net \$22,500,000, maximum ceded \$2,500,000.

Captives: The Company's captive book of business is primarily composed of Professional Liability, including hospital and physicians, architects & engineers and lawyers professional. All policies written are on a claims-made basis. Coverage is essentially primary, with 100% of the policy exposure ceded to the client's captive reinsurer. Limits of liability are usually \$1,000,000 to \$3,000,000 per claim, with the lowest being \$200,000 and the highest being \$20,000,000. Exposures are sometimes limited by a policy aggregate limit of liability, however most policies are using a company determined actuarial loss pick, with attendant security based on that amount. Medilink Insurance Company, MPC Insurance, Hamden Assurance, and Onika Insurance Company were the Company's largest captives at December 31, 2008.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2008

Underwriting and Investment Exhibit for the Year Ended December 31, 2008

Reconciliation of Surplus as Regards Policyholders
from December 31, 2005 through December 31, 2008

Statement of Financial Condition
as of December 31, 2008

<u>Assets</u>	Ledger and Nonledger Assets	Assets Not Admitted	Net Admitted Assets	Notes
Bonds	\$ 353,565,584	\$	\$ 353,565,584	
Cash and short-term investments	50,305,751		50,305,751	
Investment income due and accrued	5,157,763		5,157,763	
Premiums and considerations:				
Premiums and agents' balances in course of collection	10,512,387	1,634,312	8,878,075	
Premiums, agents' balances and installments booked but deferred and not yet due	5,654,165		5,654,165	
Reinsurance:				
Amount recoverable from reinsurers	6,901,518		6,901,518	
Funds held by or deposit with reinsured companies	20,298		20,298	
Current federal and foreign income tax recoverable	6,274,584		6,274,584	
Net deferred tax asset	14,283,798	8,961,731	5,322,067	
Furniture and equipment	41,702	41,702		
Receivables from parent, subsidiaries and affiliates	75,216		75,216	
Aggregate write-ins for other than invested assets	<u>1,180,024</u>		<u>1,180,024</u>	
Total assets	<u>\$ 453,972,790</u>	<u>\$ 10,637,745</u>	<u>\$ 443,335,045</u>	
<u>Liabilities, Surplus and Other Funds</u>				
Losses			\$ 173,216,242	(1)
Reinsurance payable			891,193	
Loss adjustment expenses			29,164,656	(1)
Commissions payable			(361,816)	
Other expenses			893,948	
Taxes, licenses and fees			299,393	
Unearned premiums			59,882,967	
Ceded reinsurance premiums payable			6,638,761	
Funds held by company under reinsurance treaties			421,924	
Remittances and items not allocated			831,271	
Provision for reinsurance			12,996,138	
Payable to parent, subsidiaries and affiliates			1,089,800	
Aggregate write-ins for liabilities			<u>1,568,666</u>	
Total liabilities			287,533,143	
Aggregate write-ins for special surplus funds	\$ 7,303			
Common capital stock	4,100,000			
Gross paid in and contributed surplus	4,733,158			
Unassigned funds (surplus)	<u>146,961,441</u>			
Surplus as regards policyholders			<u>155,801,902</u>	
Total liabilities, surplus, and other funds			<u>\$ 443,335,045</u>	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2008

Statement of Income

Underwriting Income

Premiums earned		\$ 104,412,859
Deductions:		
Losses incurred	\$ 70,084,170	
Loss expense incurred	13,936,510	
Other underwriting expenses incurred	<u>15,562,758</u>	
Total underwriting deductions		<u>99,583,438</u>
Net underwriting gain		4,829,421

Investment Income

Net investment income earned	\$ 16,024,629	
Net realized capital losses	<u>(42,712)</u>	
Net investment gain		15,981,917

Other Income

Net loss from agents' balances charged off	\$ (1,364,244)	
Aggregate write-ins for miscellaneous income	<u>74,751</u>	
Total other income		<u>(1,289,493)</u>
Net income before federal income taxes		19,521,845
Federal income taxes incurred		<u>3,328,382</u>
Net income		<u>\$ 16,193,463</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2007		\$ 146,007,832
Net income	\$ 16,193,463	
Change in net deferred income tax	1,666,480	
Change in nonadmitted assets	(1,093,174)	
Change in provision for reinsurance	(7,299,468)	
Surplus adjustments: Paid-in	333,158	
Aggregate write-ins for losses in surplus	<u>(6,389)</u>	
Change in surplus as regards policyholders		<u>9,794,070</u>
Surplus as regards policyholders, December 31, 2008		<u>\$ 155,801,902</u>

Reconciliation of Surplus as Regards Policyholders
from December 31, 2005 through December 31, 2008

Surplus as regards policyholders, December 31, 2005, per Examination. \$ 98,347,322

	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>
Net income	\$ 70,557,360	\$
Net unrealized capital losses		11,864
Change in net deferred income tax	3,042,656	
Change in nonadmitted assets		5,488,490
Change in provision for reinsurance		11,038,866
Surplus adjustments: Paid-in	333,158	
Aggregate write-ins for gains in surplus	<u>60,626</u>	
Totals	<u>\$ 73,993,800</u>	<u>\$ 16,539,220</u>

Net increase in surplus as regards policyholders 57,454,580

Surplus as regards policyholders, December 31, 2008, per Examination. \$155,801,902

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

The reserves for losses and loss adjustment expenses (LAE) were reviewed at the Surplus Lines Pool (Lexington Pool) level by a consulting actuary from INS Consultants, Inc. (INS). The conclusions set forth in the consulting actuary's report are based on information provided by the Lexington Pool. The examination team from INS performed substantive testing of the underlying losses and LAE data provided to the consulting actuary and concluded that the data was reliable. Based on work performed, the consulting actuary found the Lexington Pool's carried December 31, 2008 net and gross losses and LAE reserves to be reasonably stated. A casualty actuary from California Department of Insurance reviewed the consulting actuary's report and concurred with the findings.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

None

Previous Report of Examination

Management and Control – Intercompany Agreements – Surplus Lines Broker Agreement (Page 10):

The Company failed to file and seek prior approval from California Department of Insurance (CDI) for this agreement as required by California Insurance Code (CIC) Section 1215.5(b)4. It was recommended that the Company comply with CIC Section 1215.5(b)4. The Company has complied with this recommendation.

Account and Records – Schedule F – Reinsurance (Page 14): It was recommended that the Company re-file an amended intercompany pooling agreement with correct language. The Company has complied with this recommendation.

Account and Records – Intercompany Transactions (Page 15): It was recommended that the Company comply with the settlement terms of the Intercompany Pooling and Service and Expense Agreements. The Company has complied with this recommendation.

Account and Records – Unclaimed Property (Page 15): It was recommended that the Company develop written procedures to track outstanding checks of \$50 and under and include these checks in the Unclaimed Property reports. It was further recommended that the Company comply with California Code of Civil Procedure, Title 10, Chapter 7, regarding Unclaimed Property Law. The Company has complied with these recommendations.

Comments on Financial Statement Items – Cash and Short-Term Investments (Page 21): It was recommended that the Company file the AIG Money Market Fund investment with the California Department of Insurance for approval to comply with C I C Section 1215.5(b)1(A). The Company has complied with this recommendation.

Comments on Financial Statement Items – Cash and Short-Term Investments (Page 21): It was recommended that the Company continue to remediate its internal controls related to its balance sheet reconciliation. One area was the Outstanding Loss Drafts (OLD) account. The Company has complied with this recommendation.

Comments on Financial Statement Items – Uncollected Premiums and Agents' Balance in Course of Collection (Page 21): A non-premium related transaction was reported in this account. It was recommended that the Company comply with the National Association of Insurance Commissioners (NAIC) Quarterly and Annual Statement Instructions for reporting amounts unrelated to premiums. The Company has complied with this recommendation.

Comments on Financial Statement Items – Uncollected Premiums and Agents' Balance in Course of Collection (Page 22): The Company failed to properly age its agents' balances and was not able to properly account for the 90-day uncollected premiums. It was recommended that the Company

comply with Statements of Statutory Accounting Principles (SSAP) No. 26, paragraph 9a. The Company has complied with this recommendation.

Comments on Financial Statement Items – Uncollected Premiums and Agents' Balance in Course of Collection (Page 22): The Company netted debits and credits between agents and between unrelated parties which was not in compliance with in compliance with SSAP No. 6, paragraph 9c. It was recommended that the Company comply with SSAP No. 6, paragraph 9c. The Company has complied with this recommendation.

Comments on Financial Statement Items – Receivable from Parent, Subsidiaries, and Affiliates and Payable to Parent, Subsidiaries, and Affiliates (Page 22): The Company established an intercompany receivable for prepaid expenses to its affiliate for future expenses that would be incurred. It was recommended that the Company comply with SSAP No. 4, paragraph 3, and SSAP No. 20 and 29, paragraph 2. The Company has complied with this recommendation.

Comments on Financial Statement Items – Receivable from Parent, Subsidiaries, and Affiliates and Payable to Parent, Subsidiaries, and Affiliates (Page 22): The Company reported a receivable from PSC, Inc., a wholly-owned subsidiary of the Company, for management expenses incurred. There was not formal agreement in place between the parties. It was recommended that the Company formalize this agreement and submit the agreement to the CDI to comply with CIC Section 1215.5(b)4. PSC, Inc. was dissolved on April 1, 2009 as part of the consolidation of the Risk Specialist companies. Therefore, this recommendation is no longer applicable.

Comments on Financial Statement Items – Provision for Reinsurance (Page 24): It was recommended that the Company categorize the authorized and unauthorized reinsurers in accordance with the listing of authorized/accredited reinsurers in California and in accordance with the NAIC Annual Statement Instructions for completing Schedule F. The Company has complied with this recommendation.

Comments on Financial Statement Items – Drafts Outstanding (Page 24): It was recommended that the Company comply with the NAIC Quarterly and Annual Statement Instructions and SSAP No. 2, paragraph 7 for the reporting of outstanding checks. The Company has complied with this recommendation.

ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and parent company's employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

/S/

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